

**MINUTES OF THE REGULAR MEETING OF THE  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON  
Friday, March 15, 2002  
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the Conference Room of the ASRS office at 7660 East Broadway Boulevard, Suite #108, Tucson, Arizona 85710-3776. Mr. Jim Bruner, Chairman, ASRS Board called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office, 14<sup>th</sup> Floor Conference Room, 3300 North Central Avenue, Phoenix, Arizona 85012.

**1. Call to Order; Roll Call**

Present: Mr. Jim Bruner, Chairman  
Mr. Norman Miller, Vice Chairman  
Ms. Charlotte Borchert (via teleconference)  
Dr. Chuck Essigs (via teleconference)  
Ms. Bonnie Gonzalez (via teleconference)  
Mr. Alan Maguire (via teleconference)  
Mr. Karl Polen (via teleconference)  
Mr. Ray Rottas  
Mr. Carl Tenney (arrived at 8:39 a.m.)

A quorum was present for the purpose of conducting business.

Mr. Jim Bruner welcomed Ms. Charlotte Borchert as a new member of the Board and, noting her distinguished career in the education field, said the Board looks forward to working with her.

**2. Approval of Minutes of the February 15, 2002, Regular Meeting of the ASRS Board**

Mr. Alan Maguire requested the minutes be clarified to better reflect his belief that the Board should routinely conduct regular meetings at different locations around the state for the purpose of meeting with employers and members. He also requested an agenda item regarding senior staff changes over the past year. Mr. Bruner said he had asked staff to provide that information to all members of the Board. Mr. Maguire said he would wait for the information before pursuing it as an agenda item.

**Motion:** Mr. Ray Rottas moved to approve the minutes, as amended, of the February 15, 2002, Regular Meeting of the ASRS Board.

Mr. Norman Miller seconded the motion.

By a vote of 7 in favor, 0 opposed, 1 abstentions, 1 excused, the motion was approved.

### **3. Board Approval of Consent Schedule**

Mr. Alan Maguire expressed disappointment that the request for proposal (RFP) process for the custodial bank contract did not take place before the deadline. Mr. Paul Matson, Chief Investment Officer, explained that the delay was due to the fact that two different RFPs would have been issued at the same time. Staff was concerned that there would not be adequate opportunity to analyze the proposals and still obtain timely information. Therefore, staff decided to delay the custody bank RFP.

**Motion:** Mr. Norman Miller moved that the ASRS Board approve the Summary Report of Retirements, Refunds and Death Benefits, the System Transfers, the Interim Contract with Mellon Bank, and the Application and Agreement with Adalberto Guerrero Middle School.

Mr. Ray Rottas seconded the motion.

By a vote of 7 in favor, 0 opposed, 1 abstention, 1 excused, the motion was approved.

### **4. Presentation, Discussion and Appropriate Action Regarding the Assignment of the Axe Houghton Contract for the SmallCap Portfolio**

Mr. Paul Matson explained that Axe Houghton had a contract with the ASRS to manage a \$145-150 million SmallCap portfolio. The principals of Axe Houghton, who have formed a new company named Byram Capital Management, LLC, have requested the SmallCap portfolio be assigned to the new company, where the same people will manage the portfolio. The ASRS staff and the ASRS consultant, Mercer Investment Consulting, have reviewed the contract and have found no outstanding issues to bring to the attention of the Board.

Mr. Norman Miller asked if legal staff had also reviewed the transfer and determined that the contract can be assigned. Mr. Fred Stork, Assistant Attorney General, answered that the assignment is possible.

Mr. Alan Maguire reiterated, as it is the Board's responsibility to oversee investment managers, it is appropriate the Board affirm the transfer of this contract.

**Motion:** Mr. Alan Maguire moved that the ASRS Board endorse the assignment of the Axe Houghton contract for the SmallCap portfolio to Byram Capital Management, LLC.

Mr. Ray Rottas seconded the motion.

By a vote of 7 in favor, 0 opposed, 1 abstention, 1 excused, the motion was approved.

**Mr. Carl Tenney arrived at 8:39 a.m.**

## 5. Presentation, Discussion and Appropriate Action Regarding the Performance of International Managers for the Period Ending December 31, 2001

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc., reported on the performance of Bank of Ireland, Brandes, Capital Guardian, Barclays Global Investors (BGI), and Bank of New York Asset Management (BNYAM) for the period ending December 31, 2001.

Mr. Michael McCarthy, Director, Portfolio Specialist, and Mr. Daniel E. Anderson, Vice President, Client Services, reported on Bank of Ireland's performance for the period ending December 31, 2001.

<b>Total Rate of Return</b>	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>Inception (10/01/98)</b>
<b>Country Weightings</b>	-0.8%	0.4%	-1.2%	-1.6%
<b>Stock Selection</b>	1.8	0.9	8.2	7.3
<b>Hedging</b>	0.2	0.3	0.2	-0.1
<b>Fees (%)</b>	-0.1	-0.3	-0.3	-0.3
<b>Other (Currency)</b>	0.4	0.7	-2.5	-0.9
<b>Total Value Added Relative to Benchmark</b>	<b>1.5</b>	<b>2.0</b>	<b>4.4</b>	<b>4.4</b>

Mr. Ian Sunder, CFA, Portfolio Manager, and Mr. Louie Nguyen, CFA, Associate Portfolio Manager, reported on Brandes' performance for the period ending December 31, 2001.

<b>Total Rate of Return (Net of Fees)</b>	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>Inception (10/1/98)</b>
<b>Country Weightings</b>	2.1%	3.3%	3.4%	N/A	2.6%
<b>Stock Selection</b>	-0.4	2.0	12.7	N/A	11.5
<b>Currency</b>	-0.2	1.0	0.8	N/A	0.6
<b>Fees (%)</b>	-	-0.4	-0.5	N/A	-0.5
<b>Other</b>	0.1	0.2	-0.4	N/A	0.3
<b>Total Value Added</b>	<b>1.6</b>	<b>6.1</b>	<b>16.0</b>	<b>N/A</b>	<b>14.5</b>

Mr. Lionel Sauvage, Senior Vice President, Relationship Manager, and Mr. Michael Nyeholt, Senior Vice President, Portfolio Manager, reported on Capital Guardian's performance for the period ending December 31, 2001.

<b>Total Rate of Return</b>	<b>Quarter</b>	<b>Cal. YTD</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>Inception (10/01/98)</b>
<b>Country Weightings</b>	1.9%	4.9%	4.9%	3.3%	N/A	3.4%
<b>Stock Selection</b>	2.8	-0.2	-0.2	5.8	N/A	5.8
<b>Hedging</b>	0.1	0.1	0.1	0.2	N/A	0.1
<b>Currency</b>	0.2	0.2	0.2	1.0	N/A	0.8
<b>Fees</b>	-0.1	-0.4	-0.4	-0.4	N/A	-0.4
<b>Total Value Added Relative to Benchmark</b>	<b>4.9</b>	<b>4.6</b>	<b>4.6</b>	<b>10.0</b>	<b>N/A</b>	<b>8.6</b>

\*The data for this report was generated from a WM Company attribution report. Due to the large cash flow in 10/98

Mr. Ray Rottas expressed concerns about Japan not making the necessary economic corrections in their country, and said he will look less favorably on the investments that are completely linked to the Japanese infrastructure. Mr. Sauvage replied that Capital Guardian uses discretion and evaluates management structures of companies to see which ones have flexibility to respond to the economy.

Mr. Norman Miller asked about the euro as a common currency. Mr. Sauvage replied that the advantage of the euro is that transaction costs have decreased and there is forced competitiveness among the countries with regard to labor costs.

Mr. David Lissek, Principal, Client Relationship Officer, reported on BGI's performance for the period ending December 31, 2001.

	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>Inception (5/31/96)</b>
<b>Net Return</b>	6.95%	-21.23%	-4.80%	1.10%	1.31%
<b>Benchmark</b>	6.98	-21.21	-4.80	1.20	1.44
<b>Total Value Added to Relative to Benchmark</b>	<b>-0.03</b>	<b>-0.02</b>	<b>0.00</b>	<b>-0.10</b>	<b>-0.13</b>

Mr. Ray Rottas thanked BGI for their years of service with the ASRS and complimented them on their continued good performance.

Mr. Seth Lynn, Consultant, Mr. Kurt Zyla, Vice President, and Dr. Robert Windsor, Vice President, reported on BNY Asset Management's performance for the period ending December 31, 2001.

<b>Total Rate of Return</b>	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>Inception (July 1992)</b>
<b>Country Weights</b>	0.0%	0.0%	0.0%	0.0	0.3%
<b>Stock Selection</b>	0.4	1.0	2.7	1.7	1.1
<b>Hedging</b>	0.0	0.0	0.0	0.0	0.0
<b>Fees</b>	0.0	-0.1	-0.1	-0.1	-0.1
<b>Other/Trading</b>	0.0	0.0	-0.1	0.0	0.1
<b>Total Value Added</b>	<b>0.4</b>	<b>0.9</b>	<b>2.5</b>	<b>1.6</b>	<b>1.1</b>

Mr. Lynn assured the Board that even though BNYAM now owns the American Depositary Receipt (ADR) product, it will continue to perform for the ASRS the way it had under Axe Houghton. Mr. Alan Maguire said he continues to have concerns about the BNY organization and will continue to watch their performance. Mr. Kurt Zyla commented that although BNY historically had some transitional problems in the custody asset segment of the bank, those issues have been corrected over the past six years. He also clarified that the ADR will be in the asset management segment of the bank.

## 6. Presentation, Discussion and Appropriate Action Regarding ASRS Governance

Mr. Jim Bruner explained that because the Board has recently lost two members with significant historical memory of the organization, he asked Mr. Fred Stork, Legal Counsel, about the statutory guidelines or policies and procedures the Board has in place. Mr. Bruner would like more clarity regarding the relationship of the Board to the staff, to the legislature, etc. He contacted a few state retirement systems, including Colorado Public Employees' Retirement Association (COPERA), which hired an outside consultant to work with the board to examine the statutes and define what the various relationships could be and should be. The COPERA board chairman was pleased with the results of that exercise and believes that board and staff are more focused. Mr. Bruner suggested the ASRS Board explore the option of utilizing an outside consultant. Though the process may be lengthy, he believes it will be beneficial for this and future Boards and staff.

Mr. Alan Maguire commented that he has had concerns about some structural issues for a number of years and believes it is good time to have a thorough review of the statutes. He also agreed it is essential that it be done by outside personnel. The consultant should be selected solely by the Board, and to further that, the procurement process must be carried out independent of the ASRS staff. He suggested the Arizona Department of Administration (ADOA) be approached to conduct that procurement and the Board be as directly involved as possible.

Mr. Norman Miller agreed the request was timely and hoped the Board would be able to analyze and absorb good ideas about governance for Boards like the ASRS around the country. Mr. Miller asked Mr. Dennison about the governance consultant arena. Mr. Dennison responded that there are only a few firms that offer the service because there is small number of potential clients. Mr. Dennison believes the process gave COPERA a strategic focus and gave that board insight as to how to work with various stakeholders, legislature and members. Mr. Miller asked about the nature of the sessions with a consultant. Mr. Dennison answered that generally there are two parts to the process: the relationship with outside entities, such as the legislature and other systems and the internal governance. Mr. Bruner added that the COPERA experience was a two-day session with the Board that resulted in 11 recommendations, primarily concerned with internal governance. Then once a year, the consultant returned for a review session.

Mr. Maguire noted that in 1982/1983 and in 1990/1991, Legislative Council staff did comprehensive reports on the relationship of the Board with the state, and both reports led to some structural changes in the law with regard to the Board, so there is some background material that may provide a good starting point.

**Motion:** Mr. Norman Miller moved to instruct ASRS legal counsel to work with ADOA to issue a request for proposal (RFP) to retain a public body governance consultant, and to further give the chairman of the ASRS Board authority to appoint an ad hoc committee of Board members to interview candidates and make a final recommendation to the full Board.

Mr. Alan Maguire seconded the motion.

Ms. Charlotte Borchers asked who would actually develop the content of the RFP. Mr. Miller responded that his motion proposes Mr. Fred Stork would review past materials and discuss with individual Board members the composition of the RFP and then work with ADOA to issue it.

Mr. Karl Polen asked who the selection committee for the RFP would be. Mr. Miller responded that the motion proposes the chairman will appoint a committee, but the full Board would ultimately make the decision. Mr. Bruner reiterated that he would like all of the Board members to be involved and be committed to the process.

Dr. Chuck Essigs commented that he believes this is a positive, proactive step, looking out for the future of the Board.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

Mr. Bruner said he would work with legal counsel to move this along as quickly as possible.

## **7. Director's Report**

Mr. Tom Finnerty, ASRS Legislative Liaison, gave a brief overview of the retirement-related bills scheduled to be heard in Senate and House committees during the next two weeks.

## **8. Board Requests for Agenda Items**

Mr. Karl Polen requested that Mellon Equity, given their poor performance, appear before the Investment Review Board Committee (IRBC) within the next month or so. He also requested, as a follow-up to a presentation given at the January IRBC meeting, a presentation to the full Board within the next two months about future contribution rates. While rate changes can be attributed to benefit changes, the reversal in the financial markets in recent months has also cut into the surplus. The topic should be discussed at a Board meeting, along with a communication strategy to the legislature and the members.

## **9. Call to the Public**

Mr. Marty Drozdoff, of the Tucson Education Association, asked about percentage increases in medical costs that the ASRS has faced. Mr. Jim Bruner asked Mr. Gilbertson to mail the information to Mr. Drozdoff and to the members of the Board. Mr. Drozdoff also asked about the effects of large company bankruptcies, such as Enron, on the ASRS fund. Mr. Dennison responded that the effect on the overall ASRS fund has been minimal. The fund is stable and benefits are secure.

Mr. Bill Peltier, of Pima County Retirees Association, commented that many retirees contributed seven percent to the retirement system, so if the contribution rates go up for current employees, the retirees will not complain.

**10. The next Regular ASRS Board meeting is scheduled for Friday, April 19, 2002, at 8:30 a.m. in the 10<sup>th</sup> Floor Board Room of the ASRS Office, 3300 North Central Avenue, Phoenix, Arizona 85012.**

**11. Adjournment of the ASRS Board.**

Mr. Jim Bruner, Chairman, adjourned the March 15, 2002, regular meeting of the ASRS Board at 11:39 a.m.

Respectfully submitted,

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Maurah Harrison, Secretary                      Date

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LeRoy Gilbertson, Director                      Date